LIHTC QAP COMMENTS
Jeff Gates
May 21, 2007

COST CONTAINMENT

Effort should be made to contain total development costs and constructions costs, particularly for properties in SE Michigan.

Having constructed LITHC projects in the City of Detroit from 1998 to 2006 I was astounded to see the escalation to the cost of construction and the cost of development. Material and labor costs were not the root of the problem. From project to project I continued to see product design and amenities grow to the point where the last project I constructed consisted of 3-story brick townhomes with 3 bedrooms, 2-1/2 baths and a 2 car garage. Furthermore I often saw affordable housing projects with Total Development Costs in excess of $175,000 per unit. I even saw an acquisition/re-hab that totaled over $200,000 per unit and it wasn't even a historical building. With a waiver of the HUD Mortgage Limit and a QCT designation, there really is no restraint on cost because every dollar spent generates a dollar of tax credit equity. There is not doubt in my mind that this scenario has resulted in waste and abuse.

There is no argument that these areas deserve good, safe, decent affordable housing, however let's provide more housing to serve more people with the tax credits, not more amenity to serve a lucky few. Garages are nice, but the mission is to house people, not cars.

I suggest that in areas with a QCT or DDA designation that the HUD mortgage limits not be waived.

RD SET ASIDE

The current 10% rural set-aside should be once again limited to USDA Section 515 properties or a separate set aside should be created for this program.

The facts about the Section 515 housing stock in Michigan are as follow: 621 properties; 18,327 units; serving 304 cities, towns and villages; 9,212 units with direct rental assistance; and 1,889 units of project based Section 8. The Section 515 program serves communities of 20,000 persons or less. While some of the communities have grown since these properties were built, most are still considered small towns. In many cases, the Section 515 properties are the only affordable housing in town and in the surrounding community.

The Section 515 housing stock has also aged. Most of these properties were built from the late 70's to the early 90's. While these properties and the units afford basic amenities, most are clearly in need of significant re-hab. Many of the building components are functionally obsolete or beyond their useful life and must be replaced. The importance of preserving and revitalizing these properties in these small, mostly rural communities cannot be understated.

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The low income housing tax credit program is the most widely used financing mechanism to acquire and re-hab Section 515 properties. While the agency has equity loans, and re-hab loans, these are all debt mechanisms which burden the property and may not be enough to substantially renovate the property. Furthermore, efforts to couple 4% credits with MSHDA tax exempt financing doesn't work.

RD properties compete with the larger urban areas where it is common for developers to submit applications seeking $1,000,000 in credits whereas an application for a typical 24 unit RD property is about $80,000. Obviously the available credits are depleted much more quickly when projects with larger credit requests are drawn before those with smaller requests.

Not long after the LIHTC program was established and MSHDA developed their QAP, there was a specific set-aside established for Rural Development Section 515 properties. At the time the Section 515 new construction program was well funded with an annual budget in excess of $500 million. The QAP provided for a 10% set-aside for RD projects. That translates to $1.8 million in credits based on the current credit ceiling.

However, in the early 90's federal funding for the Section 515 program was cut back to almost nothing. Not long thereafter, the QAP definition for the Rural Set-aside was modified to include not only Section 515 financed properties, but also properties located in "an area other than a metropolitan area." This means that any project located or planned in a rural area can compete in this set aside.

Consequently the playing field for credits in rural areas has become very competitive for Section 515 owners and developers. In fact all too often we find ourselves competing against projects located in areas which arguably are metropolitan versus rural.

While preservation and new affordable housing must continue to grow in rural areas, I believe that it is important and critical to preserve and renovate the existing Section 515 portfolio. Most markets served by Section 515 properties cannot support new development. In many cases all these existing properties need is a good re-hab to improve their market position and attract and retain persons that need affordable housing. The result is good, safe, decent affordable housing that will last for many years to come.

Quite often we see the re-development of small communities proceeding hand-in-hand with RD re-development. I recall in Newaygo 2002 when we acquired and re-habed Autumn Grove Apartments. We were seeking a PILOT and concurrently the City was initiating plans to re-develop their downtown. The PILOT was approved, the City approved their re-development plans and now both are flourishing.

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The Section 515 program coupled with the LIHTC program is a very efficient combination to preserve affordable housing. The average credit allocation is $3,000-$5,000 per unit and the way it is applied provides dramatic results to the properties. There is a night and day difference from pre-rehab to post re-hab. By comparison, credits allocated for new construction can run upwards of $20,000 per unit. In addition to RD's role in providing affordable housing in rural communities, RD also takes an active role in community development and economic growth with programs to provide childcare facilities, fire and police stations, libraries, community centers and other public facilities. RD is also a key provider of financing for water and sewer systems for rural communities. Rural Development does as it's name implies.

In order for the revitalization of the Section 515 portfolio to continue at a reasonable pace, **I suggest that there be a 5% set aside of total annual tax credit ceiling reserved solely for Section 515 preservation.** This 5% set aside would equate to approximately $900,000 in credits. Very simply this would be half of the current rural set aside. The set aside should not differentiate between the use of 4% and 9% credits.

At this level of set aside there would be guaranteed funding for the annual preservation and re-hab about 250 units. This would equate to about 10 properties per year. Important to note is the dispersion of credits would most likely be to 10 communities. By contrast, a single project receiving the same amount of credits would generate far fewer units and benefit only one community.

PRESERVATION

Without a doubt the preservation set aside should be increased. It is the most efficient use of tax credits of any existing set aside. The employment market in Michigan is shrinking and with it shrinks the housing market, whether it is for sale, rental, affordable, or high end. The extent of aged housing stock in Michigan is significant and much of it is in need of re-hab. The use of the tax credit for preservation purposes results in a significant improvement to the property, the neighborhood and community surrounding it, and the quality of life for the residents.

What I also find great about preservation, and in particular the preservation of RD Section 515 properties is that even after re-hab our rents are substantially lower than the rest of the market place. Case in point is Oak Terrace Apartments, a senior project in Traverse City. We will spend over $20,000 per unit renovating the property and at the end of the day the development will look like new. Yet our rents for our seniors will be no more than $409 per month and that includes heat and hot water. By comparison the market for affordable housing in the Traverse City area starts in the low $600 range. That's a significant difference.

I suggest that the set aside for Preservation be increased to 50% of the annual tax credit ceiling.

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TRENDING FACTORS

An adjustment should be made to the Income and Expense trending factors as they relate to USDA Rural Development acquisition/re-hab properties.

The current annual trending factors are 2% for income and 3% for expenses. These levels handicap the Section 515 properties because the rents at these properties are significantly lower than market and have been suppressed for years. Expenses on the other hand have been unrestrained and are comparable to new projects. The problem that results is that it is often difficult to achieve the underwriting criteria of a 1.05 debt service coverage ratio in Year 15 without a healthy increase in the rent in Year 1. These properties have an operating history and it is not uncommon to see annual rent increases in the 4-5% range so it is not unreasonable to suggest an increase to the income trending factor.

I suggest that for RD acquisition re-habs that the trending factor for income and expenses be 3%.

LIMIT ON TC RESERVATION

The LIHTC is a valuable and very limited resource that should be awarded judiciously. The amounts requested in applications continue to grow and requests exceeding $900,000 are common place, and requests upward of $1.3 million. The problem with these mega-projects is the drain it has on the tax credit pool and how all too quickly a specific set aside ends up serving one or two projects.

I suggest that a $750,000 limit be set for any tax credit application. Furthermore I suggest that there be a per unit tax credit cap to promote the efficient use of tax credits.

SMALL PROJECT SET ASIDE

This set aside started with the best of intentions but it does not serve the program well. This set aside if filled with applications in the $400,000 to $500,000 range. One even at $586,000 in the September round. That's almost $25,000 per unit and probably $200,000 per unit in Total Development Cost. My estimate is that the developer fee is close to $650,000 and the construction OH & P is close to $200,000. To earn over $800,000 on a 24 unit project is just wrong.

This program was previously limited to 12 units or less and it was administered on a first come, first served basis. Numerous successful properties were developed under this program and in urban markets it worked well for small neighborhood CDC's and non-profits. San Juan Square Townhomes is a nice example of how well this program worked.

I suggest that the Small Project Set Aside be revised to 12 units or less and limited to a tax credit awarded not to exceed $16,000 per unit.

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<u>FUNDING ROUNDS</u>
It is imperative that the LITHC program continue to have two funding rounds. I further suggest that application dates be March 15 and September 15.

<u>STAFFING</u>
It is imperative that MSHDA increase its staffing levels in processing, environmental, and marketing in order to administer the program in a timely manner.

<u>LOTTERY</u>
I support the continued use of the lottery system. Our team puts a great deal of time, effort and money into our applications. We believe we assemble good projects and good applications and although there is a bit of luck in the order of draw, the applications must still past the test of a diligent review.